



Date: July 22, 2014

To: Thomas J. Bonfield, City Manager
Through: Keith Chadwell, Deputy City Manager
From: Reginald J. Johnson, Director
Department of Community Development
Subject: Presentation for the Preservation of Affordable Rental Housing

Executive Summary

In response to the City of Durham's application for funding of CDBG, HOME, ESG and General Funds for FY 2014-2015, Durham Community Land Trustees, Inc. (DCLT) and Woodland Associates, Inc., submitted applications for funding being made available for the preservation of existing affordable rental units. The requested funds would be used to make urgently needed capital and accessibility improvements to each of the affordable Low Income Housing Tax Credit (LIHTC) projects.

All of the rental developments listed below (Rockwood Cottages Apartments, Mutual Manor Apartments, Mathison Apartments, Morehead Glen and West Park) are currently in compliance with federal tax credit program rules and requirements and City rent restrictions. Compliance with rent restrictions has not allowed the projects to build sufficient replacement reserves to meet their capital improvement needs. In order to allow the developments to continue to serve individuals and families whose income does not exceed 50% - 60% of Area Median Income, the owners are requesting City funds to help address immediate capital improvement needs.

Recommendation

The Department of Community Development recommends that City Council receive a presentation regarding the requested funding for the preservation of affordable rental units and its inclusion in the Department's funding plan.

Background

The Five-Year Funding Plan presented to City Council on May 5, 2014, included a recommendation by the Department to provide for capital improvements from the Dedicated Funding Source (DFS) to preserve existing affordable rental units and the affordability of those units. The funding for Rockwood Cottages, Mutual Manor Apartments and Mathison Apartments was requested by Woodland Associates, Inc. and the funding for Morehead Glen Apartments and West Park was requested by DCLT.

Rockwood Cottages Apartments

Rockwood Cottages Apartments is an affordable 20-unit elderly housing development located at 1 Rock Cottage Court in Durham. The owners, Rockwood AH-1, LP have operated Rockwood Cottages for 18 years. The owners are requesting a total of **\$197,838.00** in City funding for immediate compliance repairs, capital improvements and replacement of aged appliances and HVAC units. The original loans totaled \$951,000.00 included an accrual of interest feature. Council authorized converting the interest rate to 0% and forgiving all the accrued interest and some principal over the remaining life of the loan. The current balance is \$931,000.00.

Mutual Manor Apartments

Mutual Manor Apartments is an affordable 18-unit elderly housing development located at 3146 Fayetteville Street in Durham. The owners, Manor Associates LP have operated Mutual Manor Apartments for 18 years. The owners are requesting a total of **\$142,859.00** in City funding for immediate compliance repairs, capital improvements and replacement of aged appliances and HVAC units. The original loan amount of \$810,800.00 has an annual forgiveness feature which has reduced the outstanding balance to \$671,770.83.

Mathison Apartments

Mathison Apartments is an affordable 9-unit scattered-site housing development located at 1401-1405 Mathison Street and 925 Fiske Street in Durham. The owners, Mathison Associates LP have operated Mathison Apartments for 20 years. The owners are requesting a total of **\$79,528.00** in City funding for immediate compliance repairs, capital improvements and replacement of aged appliances and HVAC units. The original loan amount of \$205,000.00 has been paid down to \$170,335.39.

Morehead Glen

Morehead Glen is an affordable 20-unit townhouse style development located in a cul-de-sac at the end of Rock Street, Durham. The owner, Durham Community Land Trustees, Inc. has operated Morehead Glen for 20 years. The owner is requesting **\$200,000.00** for immediate capital improvement needs. The original loan amount of \$474,105.00 has been paid down to \$306,905.08.

West Park

West Park is an affordable 10-unit townhouse style development located on three (3) scattered sites; 811 Carroll Street (4 units), 827 Exum Street (3 units) and 1009 Cornell Street (3 units). The owner, Durham Community Land Trustees, Inc. has operated West Park for 21 years. The owner is requesting **\$100,000.00** for immediate capital improvement needs. The original loan amount of \$261,556.00 has been paid down to \$87,005.40.

It should be noted that in some instances, the City loans for the above projects are more than 20 years old, but payments on all City loans have always been made on time, by both DCLT and Woodland Associates, Inc. There has never been a delinquency or a default.

In putting together the guidelines and instructions for the competitive application process for ESG, CDBG, HOME and DFS, the Department was aware of these specific older LIHTC projects that did not meet the Qualified Action Plan (QAP) 24-unit minimum under the “rehabilitation set-aside”. That set-aside was created by the North Carolina Housing Finance Agency (NCHFA) to provide a source of major capital improvement funding for older LIHTC projects. Given that the Whitted School project was already in the 2014 pipeline for LIHTC and it was strategically important to not have another application submitted from Durham County, the Department saw that year as a largely one-time opportunity to provide capital improvement funding to these older projects that had essentially fallen between the cracks. Funds were therefore advertised for new rental projects that would not be in competition with the Whitted School and for the preservation of older LIHTC projects that did not meet the 24-unit minimum.

The above referenced projects were all originally funded in part through the sale of LIHTC with a 15 year compliance period. In addition, the City imposed rent and income restrictions for eligible elderly or family populations whose income did not exceed 50 - 60% of Area Median Income (AMI), with several units further restricted to income levels of 35% AMI, as defined by HUD. For DCLT properties, income restrictions of 45% AMI were imposed when they were placed in service under the LIHTC program.

It was anticipated that these loans would be reviewed and modified or restructured at the expiration of the 15 year federal compliance period. The compliance period for all projects has now expired, the investor partners have withdrawn from the ownership entity and to varying degrees, each project is struggling to generate enough income to meet its annual operating budget and adequately fund replacement reserves and capital expenditures.

In 2013, City Council approved a partial restructuring of the loans for Mutual Manor and Rockwood Cottages, by reducing debt service on the City loans from 2% interest rates to 0%, allowing income to increase slightly, by raising the income restrictions on those few units limited to 35% AMI and by forgiving principal repayments. Although these actions brought some immediate financial relief to these properties, it did not

provide for long term, on-going capital improvements and funding replacement reserves. In order for the owner to keep these properties affordable and economically viable for Durham residents for the long term, they must be able to maintain the physical integrity of the properties.

All of the above referenced properties are at or approaching 20 years of age, and are in need of major capital expenditures, to include new roofs, new HVAC units, new appliances, parking lot repaving/stripping, etc. Mathison Apartments, Morehead Glen and West Park, are all experiencing similar struggles in trying to keep the rents at affordable levels and continue day to day operations. Current replacement reserves for all properties are not sufficient to adequately fund the capital improvements and replacements now necessary for these aging properties. The North Carolina Housing Finance Agency now requires all new rental properties financed in part with LIHTC, to fund the replacement reserve accounts with a minimum of \$250.00 per unit annually.

Based on actual income and expenses provided by Woodland and DCLT, the following operating pro-forma is provided for illustrative purposes for a “typical” 2 bedroom unit:

Revenue

Rent	\$535.00
Vacancy/bad debt 8.5%	45.65
Rent Loss for Grandfathered Tenants	<u>10.71</u>
Effective Gross Income	\$478.64

Expenses

Administrative	59.67
Property Manager	31.90
Property Insurance	27.39
Property Taxes	37.01
Maintenance Salary	73.44
Maintenance Supplies	34.19
Lawn Service	24.43
Phone	2.24
Utilities	38.45
Marketing	3.25
Mortgage Principal & Interest	<u>98.21</u>
Total Operating Expenses	\$430.18

Net Operating Income	\$48.46
Replacement Reserves	\$31.89
Cash Flow	\$16.57

At these levels, the properties will generate enough income to fund the replacement reserve accounts for future needs.

Woodland Associates, Inc. is a for profit organization that has developed and owned many affordable rental communities in Durham including, Mathison Apartments, Mutual Manor Apartments, Rockwood Cottages, Underwood Apartments and most recently, the complete renovation of the 147 unit former Mutual Heights Apartments, now known as Stewart Heights. Woodland currently manages 400 affordable residential elderly and family rental units developed by the company's founder, James W. Pou.

Durham Community Land Trustees, Inc. is a nonprofit, community-based organization, whose mission is to provide permanently affordable, community and resident controlled housing for low and moderate income persons and to promote revitalization of neighborhoods in Southwest Central Durham. DCLT has been renovating single family houses in the West End neighborhoods since 1987, many of which were developed for lease-to-purchase and managed by DCLT. DCLT currently manages approximately 117 rental units for special needs, supportive housing, elderly and market rate tenants.

Issues and Analysis

For the reasons enumerated above, current replacement reserves are inadequate to fund the major capital improvements and necessary replacements. The loan modifications previously approved by City Council for Mutual Manor and Rockwood Cottages, will allow the properties to increase projected cash flow over time, to fund future needs.

Since the investors exited the partnership in 2010, DCLT has taken sole ownership interest in Morehead Glen and West Park. At the time DCLT took over the properties the maximum income of eligible tenants was 45% of the area median. DCLT requested and obtained approval from NCHFA to raise maximum income limits to 60% of the area median which has allowed for rent increases as units have turned over. Another major challenge was to "clean up" Morehead Glen by removing some undesirable tenants and increase the lease-up. Both properties were in critical need of capital improvements. Although DCLT has continued to contribute to the replacement reserve accounts, it was insufficient to take care of all the major capital improvements. They hired a consultant to conduct a capital needs assessment for

both properties in order to identify the long term needs and a plan to address these needs. This assessment formed the basis of their funding request. DCLT also intends to pursue refinancing the first mortgage loan for Morehead Glen which is currently at 8% interest in order to increase cash flow.

All of the properties owned by Woodland and DCLT are able to cover their current operating costs and contribute to their reserve accounts, to cover future needs, but are unable to cover the current major costs of renovating the properties to address some health and safety issues, such as new windows, repaving parking lots, replacing HVAC units, replacing kitchen and bath cabinetry, countertops, new roofs and appliances. The requested funding for these properties would bring them up to a standard that will allow them to operate at an optimal level and ensure that safe, descent, affordable housing remains available to Durham residents. Once these building components are all repaired/replaced, these properties will be able to fund future replacements from their own replacement reserve accounts, without a need to seek additional outside funding. In addition, to accommodate the City's initial desire to keep rent levels affordable for Durham residents, some of whom are seniors, the limited cash flow generated was insufficient to adequately fund the replacement reserves, beyond making the minimum immediate repairs. There is a very strong demand for affordable rental units and funding this request will not only protect the City's prior investment, but will continue to provide much needed affordable rental housing for Durham residents for many years to come.

The requested funding, if approved by Council, will be structured as forgivable loans at 0 % interest for a period of fifteen (15) years. The DCD will continue to monitor all projects to ensure they are all making adequate contributions to the replacement reserve accounts to sustain the properties going forward.

Alternatives

If the requested funding for the preservation of affordable housing is not approved by Council, the alternative would almost ensure that the owners would not be able to meet the physical needs of the properties. If that was to occur, the properties would either fall into a state of disrepair, or could be sold to investors, resulting in a loss of as many as 77 affordable rental units, since at least some of the properties would attract market rate tenants.

Financial Impact

Not applicable with this request to receive a presentation, but should the item move forward for Council approval, the impact will be noted on a future Agenda Memo.

SDBE Summary

Not applicable

Attachment:

PowerPoint Presentation